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THE MAGAZINE FOR GROWING COMPANIES

Inc.

OCT. 1987
$3.00

RATING THE STATES
The Best and Worst Business Climates
PAGE 76

'WHY I FIRED STEVE JOBS'

Apple Chief John Sculley on Managing Company Founders, Crises, and Change

PAGE 48

JOHN SCULLEY

PAGE 65
Cookies and Computers:
Mrs. Fields' Secret Recipe

PAGE 145
Managing People:
The Art of Hiring '10s'

PAGE 161
Taxes:
Dealing with T&E Expenses,
Second Cars, Capital Gains

PAGE 15
The New Economy:
How to Find the Booming
Hidden Market
By David L. Birch

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CONTENTS

FEATURES

65 Mrs. Fields' Secret Ingredient *BY TOM RICHMAN*
The real recipe behind the phenomenal growth of Mrs. Fields Cookies cannot be found in the dough

78 INC.'S ANNUAL REPORT ON THE STATES
Coast to Coast *BY JOSHUA HYATT*
This year's survey tells a tale of two economies

78 The New Role Models *BY DAVID OSBORNE*
Which states are the real innovators in economic policy?

92 Can this Company Be Saved? *BY ROBERT A. MAMIS*
Cardinal Services is slipping toward bankruptcy. Time is running out

108 Are We Having Fun Yet? *BY JOSEPH P. KAHN*
John Paul Mitchell Systems is a new-wave profit machine with few moving parts and a direct connection to Paradise

115 Sole Survivors *BY JOSHUA HYATT*
How Servus Rubber beat the price squeeze from Asia

124 HOME, INC.
The House that Re/Max Built *BY MARTHA MANGELSDORF*

COLUMNS

15 The New Economy: The Booming Hidden Market. *BY DAVID L. BIRCH*
There are companies that need what you're selling. The trick is finding them

19 The Mind of a Manager: Mastering the Numbers. *BY PAUL HAWKEN*
Developing the tools you need to figure out what's happening in your business

22 Required Reading: The Sounds of Silence. *BY JOHN CASE*
Why are good business tapes so hard to find?

26 Start-ups: Mother of Invention. *BY PAUL B. BROWN*
Lots of businesses are born of necessity, but few of so frightening a necessity

31 Viewpoint: The Corpocracy's Last Gasp. *BY STEVEN PEARLSTEIN*
The Hobson's choice between raiders and corporate managers

38 Profile: A Rose Blooms in Houston. *BY CURTIS HARTMAN*
From abused wife to successful company president: meet Rosemary Garbett

145 Managing People: The Art of Hiring '10s'. *BY I. MARTIN JACKNIS*
Why your new recruits may not be as sharp as the people you used to hire

149 Marketing: Many Happy Returns. *BY STEPHEN NELSON*
How to sell your product as a financial investment

153 Banking: Mixed Signals. *BY THOMAS E. BENNETT JR.*
Your company may be doing fine, but that may not be the way your banker sees it

155 Operations: Quality Nightmares. *BY CHARLES W. KYD*
You can't ignore a quality problem until 'things get better'—because they won't

161 Taxes: Cash Savers. *BY IRVING L. BLACKMAN*
How you should treat T&E expenses, second cars, and capital gains

DEPARTMENTS

7 Letters: Counterrevolutionaries

10 Insider: Computer Literacy; Coming Distractions

48 Face-to-Face: Corporate Antihero John Sculley

140 Hands On: A Manager's Notebook

172 Investing in Growth Companies

INC. COVER STORY

48 Corporate Antihero
John Sculley on creating a new order at Apple

65 Mrs. Fields
Managing information in the computer age

78 States Report
A look at the states that are the real innovators

COVER PHOTOGRAPH
by
Tom Zimberoff

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THE BOOMING HIDDEN MARKET

There *are* companies out there that'll need what you're selling. You just haven't heard of them yet

BY DAVID L. BIRCH

Are you finding it tougher and tougher to maintain growth and market share? Do your competitors seem to have some edge that you lack? Do you ever get the feeling that new-business development is playing a more important role in your company's fate? I'm not surprised, and you are not alone. Either you're caught in a down draft in our increasingly turbulent economy, or you're doing business with a company that is.

The down drafts are part of an economy that last month I compared with a huge thundercloud—peaceful and generally unchanging when viewed from the outside (in the aggregate) but chaotic on the inside. The cloud is dominated by hundreds of thousands of rapidly rising companies (mostly smaller in size) offsetting the declines of hundreds of thousands of rapidly sinking ones (mostly larger). For any business selling goods or services to other businesses, these updrafts and down drafts mean trouble, or opportunity, or both. Understanding the activity in the cloud will help you understand the companies you're selling to now, and the ones you might want to be selling to instead.

Historically, many businesses have focused their marketing and selling efforts on larger companies because these are the easiest to identify and the most efficiently reached. Unfortunately, larger companies have been particularly prone to finding themselves in a down draft. During the years 1980 through 1986, *Fortune* 500 companies alone laid off a net 2.8 million workers—the rough equivalent of today's entire labor force in Massachusetts. Large corporations have been the most severely affected by international competition, an overvalued dollar, and a host of other problems.

Yet while so many large businesses have been struggling, nearly 10 million jobs have been *added* to the U.S. economy. Virtually all of that growth on a net basis has come from companies with fewer than 100 employees. And most of it comes from a relatively few businesses buried in a sea of some 7 million others that are scarcely changing. Figure 1 shows that over the past five years, the top 5% of companies, ranked by growth, created 83% of the jobs added by all companies that existed at the start of the period. The top 10% created 93% of all new jobs.

FIGURE 1

	Percent of Gross New Jobs Created
	83%
	93%
	98%

Almost every new job in the United States is created by a small group of fastest-growing companies. (The percentages represent "gross" additions, not percentages of "net" new job totals that would result after subtracting job losses by declining companies. The percentages of net new jobs created by rapidly growing companies are well over 100%.)

What more is known about these select rapid growers? Usually, they start very small. As figure 2 shows, a large majority of the past half-decade's fastest-growing enterprises began the period with fewer than 20 employees. Also, they are volatile. They grow, but not on a consistently rising line. Of course, the discovery that growth and volatility go hand in hand should come as no surprise. Risk, growth, and uncertainty are all parts of the same equation.

FIGURE 2

	Percent of Indicated Rapidly Growing Companies that Started with Employment of:				
	0–19	20–99	100–499	500–4,999	5,000+
	63.7%	24.3%	8.5%	3.0%	0.4%
	79.5%	17.0%	3.1%	0.5%	0.1%

This newly turbulent economy has brought managers an enormous marketing challenge. The old tried-and-true customers who used to buy a lot are struggling. And their places are being taken by a relatively few rapidly growing, unstable companies, most of which emerge quickly out of a morass of 7 million smaller concerns.

These companies—tomorrow's expanding market—are tough to find exactly when you most want to find them: at the point when their growth creates huge needs and when they are forming their first (and perhaps lasting) bonds with suppliers. To capture them as customers, you must switch from doing an excellent job of selling to a few obviously visible companies to doing an excellent job of selling to a few mostly invisible smaller companies. The latter will become the big companies in the near future; today they represent virtually all the growth in the economy. A real change is taking place, and you are going to have to change with it. If you wait for the new crop of companies to "grow up," there is a good chance your competitors will already have nailed them down as customers.

And if you succeed in finding the next crop of rapid growers? Then your marketing task will be complicated by their volatility. Their growing pains and fluctuations of fortune will become your problems. Still, your understanding of their volatility could become a major selling point if you can tailor your product or service (and the terms under which you offer it) to your customers' ups and downs.

The struggle to meet these challenges will likely be worthwhile. It is hard to imagine that companies that locate and successfully cater to the rapid growers will not be richly rewarded.

However, a few cautionary observations are in order. While trying to capture the major source of growth in the economy, you can't afford to ignore several other groups of companies. The first are the growing businesses that happen to be large. In many cases, these are rapidly growing, small companies that simply outgrew the "small" category. Their founders may be still directly or indirectly involved. Wal-Mart Stores, Compaq Computer, K mart, Digital Equipment, Federal Express, and Mrs. Fields Cookies come immediately to mind. Such companies are obviously not to be ignored, but the competition to win their business is very intense. *(continued)*

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THE NEW ECONOMY

Large, declining companies also may be perfectly acceptable targets for particular products or services: consulting services, for example, or real-estate management (to deal with the consolidations taking place), and of course outplacement assistance, whose entire purpose is to help declining companies in the process of finding jobs for the workers they no longer need.

Last, but certainly not least, is the vast pool of steady-state companies—a pool that includes the majority of companies in our economy. These businesses don't change much (nor do their needs) but their number is large. They all need to replace the supplies they use, the people who leave, and the equipment that wears out or becomes obsolete. And they all need to manage their money, their travel, their retirement plans, and their insurance. The problem is that they are much less likely to make a decision in the next 12 months or to switch suppliers at all—because their world is, almost by definition, in balance. And, most important, they are extremely unlikely to become the WalMarts and Apple Computers of the future. Selling to them is expensive, and the long-term payoff is no greater than the payoff you receive today.

Discussion of other company groups aside, it remains true that a small group of rapidly growing companies accounts for most of the action in today's turbulent economy. Important as that may be, more critical is understanding what kinds of companies you are dealing with in "economic thundercloud" terms. If you want to consciously focus your efforts on large, declining businesses, that's fine so long as you know: first, that that is what you're doing; and second, that in the slightly longer term, your market will be rapidly shrinking. If you want to focus on the *Fortune* 1,000 and *Fortune*'s Service 500, that's fine too, so long as you're aware that the competition will be very tough and the net growth very small—if there is any. If you want to market to the large pool of stable companies, that's fine so long as you do so knowing that you are missing most of the next wave of economic growth in the United States. And if you want to identify and sell to this next wave, you should remember that it is a volatile, difficult group of companies to identify and hang on to.

In short, whatever you're doing, you ought to make sure you realize *what it is* you're doing, and design your products, terms of sale, and marketing strategy to fit the dynamics of the companies you are trying to reach. □

David L. Birch is president of Cognetics Inc. and director of MIT's Program on Neighborhood and Regional Change.

COAST TO COAST

This year's survey tells the tale of two economies. The one that's flourishing has top universities, a strong technology base—and an ocean view

One is prosperous, while the other is still in the throes of a deep recession. One boasts of fine universities and information-intensive businesses, while the other mourns the loss of farms, factories, and oil rigs.

The U.S. economy has become bicoastal. Need proof? Look no further than this year's Report on the States. Of the top 10 states, 8 look out upon an ocean. And the 2 land-locked states, Arizona and Nevada, have a coastal state to thank for their economic growth.

The coastal states are not simply rising on the tide. Their economic growth has strong underpinnings: a decades-long transition from heavy industry to service businesses, and a reliance on the commercialization of technology developed at top research universities.

Look, for example, at Massachusetts (#9), home to about 65 institutions of higher education. A one-square-mile piece of land near Massachusetts Institute of Technology has outperformed each of 13 states in terms of job creation since 1980. And the area's strong economy has spilled over to woodsy New Hampshire (#2). "New Hampshire has attracted people who want low-to-no taxes, yet still want to be near rapid growth," says Ted Lyman, associate director of the Center for Economic Competitiveness at SRI International. Similarly, Maryland (#3) and Virginia (#5) benefit from the service and technology growth around the nation's capital. The federal government has also enabled Florida (#6) to blast off. Aided by the space program, the state has added the electronics industry to its healthy base of tourism. It is also enjoying the rewards of entrepreneurship among many of Miami's Cuban immigrants.

California (#8) continues to profit from the engineering prowess of its universities and the spin-off activity among its technology companies. Its growth has helped Nevada (#10), too: Reno and Las Vegas have absorbed some of the expansion from San Francisco and Los Angeles, respectively. California's growth has also given #1 Arizona a big lift. With its cheaper land and labor, Arizona has become a refuge for high-tech companies seeking relief from crowded Silicon Valley.

Georgia (#4), with its impressive universities, Atlanta's expanded airport, and extensive interstate highways, has positioned itself as a regional hub for the entire fast-growing Southeast. As a result, it has been able to nurture small high-tech companies and service businesses that cater to regional distribution offices.

Delaware has reached #7 by a different route—a concerted effort to round out its manufacturing-based economy, long exemplified by E. I. du Pont de Nemours & Co. By offering special tax incentives, for instance, the second smallest state has added roughly 9,000 banking jobs since 1981. And Delaware has become one of the major processing centers for credit-card operations.

The future doesn't look nearly as bright for states still dependent on oil, agriculture, and heavy industry. The latest to take a hard fall in the rankings is Alaska. After weighing in at #2 last year, its ranking fell further than the mercury on a Juneau night. This year, it tumbled into the 39th slot.

—Joshua Hyatt

WHAT THE RANKINGS MEAN

This year's rankings measure how a state is actually doing in stimulating entrepreneurial activity and economic expansion. A state's position on the list reflects its economy's relative success, over a four-year period, in three areas: job generation, new-business creation, and young-company growth.

JOB GENERATION. The figures in columns 1 and 2, from the federal government's Bureau of Labor Statistics, indicate a state's gain (or loss) in private-sector and civilian public-sector employment between February 1983 and February 1987.

NEW BUSINESSES. The figures in column 4, compiled for the Report on the States by Cognetics Inc., in Cambridge, Mass., include all companies founded in 1983 or later that had at least 10 employees by January 1987. The "birthrate" in column 5 is this number divided by the total number of business establishments in the state.

YOUNG-COMPANY GROWTH. Column 7, also compiled by Cognetics, lists all the companies founded in 1979 or later that registered a growth index of at least 20 between the beginning of 1983 and the beginning of 1987. What's a growth index? Simply the company's *absolute* growth in employment multiplied by its *percentage* growth in employment (expressed as a decimal). Say you employed 50 people in January 1983 and 75 people in January 1987. Your growth index would be 25 x .50, or 12.5—not enough to make the list. Figuring growth in this way eliminates any bias in favor of large companies (which might have high absolute numbers) or small (which might have high percentage numbers).

Column 8 is the number of these young, fast-growing companies divided by all of a state's business establishments founded in 1979 or later.

SCORES. A state's scores (columns 3, 6, and 9) are computer-generated rankings that reflect how it stands in relation to all the other states. The top state in any one category gets a score of 33.33, the bottom state a score of one. Every other state is assigned a number reflecting its relative position on an imaginary scale between the top and the bottom. The top possible score is 100.

All scoring is based on a state's ranking in the percentage columns, not in the absolute-numbers columns. Column 10—the bottom line, so to speak—is the sum of the other three "score" columns.

GRAPHIC: IMAGEBUILDER DESIGN

RATING THE STATES 1987: NEW JOBS, NEW COMPANIES, AND THE CLIMATE FOR GROWTH

Rank/State (1986 rank)	No. New Jobs (in thou.)	Growth in Jobs	Score	No. New Companies	Business Birth Rate	Score	No. Fast-Growth Companies	% Fast-Growth Companies	Score	Total Score
	1	2	3	4	5	6	7	8	9	10
1. ARIZONA (1)	334.7	32.18%	33.33	1,955	3.80%	33.33	418	3.57%	31.10	97.77
2. NEW HAMPSHIRE (4)	107.2	27.82	29.68	496	2.51	17.65	115	3.56	30.99	78.32
3. MARYLAND (6)	314.0	19.08	22.36	2,046	2.93	22.76	496	3.66	32.16	77.27
4. GEORGIA (5)	527.5	24.02	26.49	2,961	3.04	24.09	601	3.02	24.66	75.25
5. VIRGINIA (10)	452.1	21.37	24.27	2,372	2.87	22.03	514	3.24	27.24	73.54
6. FLORIDA (7)	942.4	24.70	27.06	6,668	3.12	25.07	1,459	2.73	21.26	73.39
7. DELAWARE (8)	50.5	19.82	22.97	238	2.39	16.19	59	3.54	30.75	69.92
8. CALIFORNIA (11)	1,720.7	17.75	21.24	13,091	2.65	19.35	3,309	3.14	26.07	66.66
9. MASSACHUSETTS (9)	397.4	15.35	19.23	2,393	2.19	13.76	601	3.76	33.33	66.32
10. NEVADA (20)	92.7	24.04	26.51	478	2.69	19.84	97	2.32	16.46	62.81
11. TENNESSEE (16)	306.0	18.44	21.82	1,917	2.68	19.72	375	2.68	20.68	62.22
12. TEXAS (3)	377.7	6.18	11.55	9,905	3.44	28.95	1,798	2.75	21.50	62.00
13. NORTH CAROLINA (15)	433.8	18.62	21.97	2,136	2.38	16.07	438	2.88	23.02	61.06
14. SOUTH CAROLINA (14)	207.5	18.11	21.54	1,249	2.72	20.20	202	2.41	17.52	59.26
15. UTAH (12)	82.3	14.98	18.92	722	2.54	18.02	162	2.68	20.68	57.61
16. CONNECTICUT (19)	214.6	15.34	19.22	1,285	2.03	11.82	338	3.18	26.54	57.57
17. NEW JERSEY (18)	439.6	14.50	18.52	3,326	2.22	14.13	731	3.01	24.54	57.19
18. VERMONT (21)	39.4	19.59	22.78	200	1.77	8.66	46	2.68	20.68	52.12
19. MICHIGAN (24)	527.5	16.93	20.55	3,038	1.99	11.33	672	2.60	19.74	51.63
20. HAWAII (34)	42.7	10.56	15.22	421	2.14	13.15	114	2.88	23.02	51.39
21. ALABAMA (28)	182.3	14.18	18.25	1,297	2.41	16.44	219	2.31	16.35	51.03
22. COLORADO (13)	100.8	7.79	12.90	1,900	2.86	21.91	366	2.27	15.88	50.68
23. OHIO (29)	508.5	12.84	17.12	3,583	1.99	11.33	817	2.68	20.68	49.13
24. WASHINGTON (27)	242.1	15.84	19.64	1,741	2.01	11.57	437	2.44	17.87	49.08
25. INDIANA (25)	285.6	14.61	18.61	1,818	2.10	12.67	326	2.42	17.63	48.91
26. MAINE (26)	75.5	18.84	22.15	361	1.79	8.90	75	2.43	17.75	48.80
27. RHODE ISLAND (22)	57.7	15.19	19.09	338	1.62	6.83	87	2.84	22.55	48.48
28. NEW YORK (23)	794.9	11.18	15.73	7,039	1.99	11.33	1,674	2.72	21.15	48.21
29. MINNESOTA (30)	229.0	13.86	17.98	1,548	1.85	9.63	379	2.56	19.27	46.88
30. NEW MEXICO (17)	61.9	13.30	17.51	524	2.22	14.13	107	2.14	14.35	45.99
31. MISSOURI (31)	237.4	12.69	17.00	1,873	1.90	10.24	380	2.28	15.99	43.23
32. PENNSYLVANIA (32)	368.8	8.40	13.41	3,555	1.75	8.41	785	2.74	21.38	43.21
33. OREGON (40)	128.1	13.75	17.89	1,087	1.86	9.75	267	2.14	14.35	41.99
34. KENTUCKY (37)	156.0	13.89	18.01	1,256	2.10	12.67	197	1.86	11.07	41.75
35. WISCONSIN (39)	209.2	11.69	16.16	1,528	1.72	8.05	329	2.22	15.29	39.50
36. ILLINOIS (38)	342.4	7.72	12.84	3,923	1.80	9.02	912	2.42	17.63	39.50
37. ARKANSAS (33)	105.9	14.88	18.83	768	1.86	9.75	144	1.82	10.61	39.19
38. KANSAS (36)	85.4	9.56	14.38	995	1.88	9.99	188	2.08	13.65	38.02
39. ALASKA (2)	12.0	6.19	11.55	250	2.26	14.61	44	1.92	11.78	37.94
40. MISSISSIPPI (41)	80.6	10.49	15.15	697	1.94	10.72	100	1.56	7.56	33.44
41. WEST VIRGINIA (46)	23.0	4.09	9.80	524	2.07	12.30	66	1.72	9.43	31.54
42. IDAHO (42)	27.2	8.95	13.87	324	1.67	7.44	59	1.56	7.56	28.87
43. NEBRASKA (44)	57.9	9.79	14.57	505	1.41	4.28	110	1.73	9.55	28.41
44. LOUISIANA (35)	-60.5	-3.91	3.09	1,605	2.19	13.76	290	1.86	11.07	27.93
45. SOUTH DAKOTA (45)	23.0	10.30	15.00	176	1.15	1.12	34	1.26	4.05	20.16
46. IOWA (48)	84.8	8.47	13.47	662	1.14	1.00	129	1.38	5.45	19.92
47. OKLAHOMA (43)	-34.7	-3.00	3.86	1,308	1.93	10.60	203	1.31	4.63	19.09
48. MONTANA (47)	7.0	2.66	8.60	284	1.35	3.55	54	1.16	2.87	15.02
49. NORTH DAKOTA (49)	3.4	1.41	7.55	192	1.33	3.31	27	1.08	1.94	12.80
50. WYOMING (50)	-12.7	-6.41	1.00	157	1.30	2.94	29	1.00	1.00	4.94